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CITATIONS

479215—42

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 256

WILGARD REALTY COMPANY, INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax appeals (R. 28–38) is reported at 43 B. T. A. 557. The opinion of the Circuit Court of Appeals (R. 49–54) is reported at 127 F. (2d) 514.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on May 15, 1942. (R. 54.) The petition for a writ of certiorari was filed July 27, 1942. The jurisdiction of this Court is invoked

under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The petitioner acquired some realty from an individual in 1932 in exchange for its capital stock and the assumption of outstanding mortgages on the property. That exchange was made non-taxable by Section 112 (b) (5) of the Revenue Act of 1932, as amended by Section 213 (f) of the Revenue Act of 1939, and as a consequence the petitioner was required to take the transferor's basis under Section 113 (a) (8) of the Revenue Act of 1936. In 1937 the petitioner sold this realty.

The sole question presented is whether Section 213 (f) of the 1939 Act is constitutional as applied here, since it keeps the 1932 exchange within Section 112 (b) (5) despite the assumption of the mortgages and thus prevents the realty from acquiring a "stepped-up" basis.

STATUTES INVOLVED

The statutes involved are set forth in the Appendix, *infra*, pp. 9–14.

STATEMENT

The facts, as stipulated (R. 25–27) and found by the Board (R. 29–30), may be stated as follows:

The petitioner, a New York corporation organized on August 12, 1932, by one Chamberlin, acquired certain realty from Chamberlin on August

16, 1932,[1] in consideration of the issuance to him of practically all its capital stock and its assumption of mortgages outstanding on the property in the principal amount of $35,000. The remaining three shares of petitioner's stock, which had been issued to the incorporators, had, in the meantime, been acquired by Chamberlin at $1 per share, so that immediately after the exchange Chamberlin owned all of the petitioner's stock. Shortly thereafter, he made gifts of about four-fifths of the stock to members of his family. (R. 26, 29–30.)

The basis of the property in the hands of Chamberlin at the time of the transfer to petitioner was its fair market value on March 1, 1913 ($65,-041.67. See R. 27.), which, after adjustment for depreciation to August 15, 1932, was $43,474.94.[2] The fair market value of the property on August 16, 1932, was $110,000. (R. 30.)

On February 18, 1937, the petitioner sold the property for $19,000 in cash and the purchaser assumed the mortgages on the property, the unpaid principal of which still amounted to $35,000. From the date of the acquisition of the property by petitioner to the date of its sale, depreciation was allowed and allowable in the amount of $8,475. The expense of the sale was $3,925.04. (R. 30.)

[1] The date of that transfer appears erroneously as August 12 in the course of the Board's opinion, instead of August 16 as stipulated by the parties. (See R. 26; cf. R. 2, 39–40.)

[2] The amount of depreciation between March 1, 1913, and August 15, 1932, appears in the Commissioner's computation (R. 20), and has not been contested.

In its income tax return for 1937, the petitioner reported the sale as resulting in a capital loss of \$51,450.04, of which it deducted the \$2,000 maximum allowable, and reported a net loss for the year. (R. 9, 18–19, 30.)

The Commissioner determined that the petitioner had a capital gain of \$15,075.02 from the sale of the property, with a resultant net income for the year in the amount of \$13,170.98, on the basis of which he asserted deficiencies in income and excess profits taxes. (R. 9–11, 18–20, 30.) The difference between the parties was solely as to the petitioner's basis for the property for computation of gain or loss from the sale, the petitioner using the 1932 value, \$110,000, while the Commissioner used the basis in the hands of the petitioner's transferor, namely, the 1913 value, \$65,-041.67. (R. 30–31.)

Before the Board of Tax Appeals, and in the court below, the petitioner claimed that it was entitled to the "stepped-up" basis because the exchange of property for stock did not fall under Section 112 (b) (5) of the Revenue Act of 1932 and hence it was not required to take the transferor's basis under Section 113 (a) (8). In support of its position, the petitioner contended, first, that the exchange was removed from the reach of Section 112 (b) (5) by the transferor's subsequent gifts of stock, and second, in the alternative, that Section 213 (f) of the 1939 Act which made Section 112 (b) (5) applicable notwithstanding the

assumption of indebtedness, was unconstitutional because of its retroactive application. The Board (R. 28–38) and the court below (R. 49–54) rejected both contentions and upheld the Commissioner's use of the transferor's basis.

The first contention has now been abandoned by the petitioner, the sole point made here (Pet. 2) consisting of the attack upon the validity of Section 213 (f) of the 1939 Act.

ARGUMENT

The petitioner acquired the property, subject to the outstanding mortgages which it assumed, solely in exchange for its stock. That exchange clearly falls under Section 112 (b) (5) of the Revenue Act of 1932 (Appendix, *infra*, pp. 9–10), as amended by Section 213 (f) of the 1939 Act (Appendix, *infra*, pp. 13–14), so that the petitioner was required to take the transferor's basis under Section 113 (a) (8) (Appendix, *infra*, p. 11).[3] Holding that petitioner was not entitled to a "stepped-up" basis for the purpose of computing its gain or loss upon sale in 1937, both the Board and the court below correctly rejected the charge, which is repeated here (Pet. 3, 4–7), that Section 213 (f) of the 1939 Act violates the due process clause of the Fifth Amendment when retroactively applied in this case (R. 35–37, 52–54).

[3] Sections 112 (b) (5) and 113 (a) (8) were substantially the same in the 1932 and 1936 Acts.

Congress expressly provided for the retroactive application of Section 213 (f) of the 1939 Act. See *D. W. Klein Co.* v. *Commissioner,* 123 F. (2d) 871 (C. C. A. 7th), certiorari denied, March 16, 1942, and *Commissioner* v. *Corpus Christi T. Co.,* 126 F. (2d) 898 (C. C. A. 5th), in which cases the application of the provisions of Section 213 (f) of the 1939 Act was approved in connection with sales occurring in the years 1932 and 1934, respectively. But the mere retroactivity of a taxing statute is not a valid constitutional objection. See *Brushaber* v. *Union Pac. R. R.,* 240 U. S. 1, 20; *Cooper* v. *United States,* 280 U. S. 409; *Milliken* v. *United States,* 283 U. S. 15; *Welch* v. *Henry,* 305 U. S. 134, 147. In *Cooper* v. *United States, supra,* a retroactive change of the basis of property was held not to be objectionable in the constitutional sense.

Only when, upon consideration of the nature of the change made by the statute, of the circumstances surrounding its enactment and of its practical effect, the statute is shown to be so arbitrary and capricious and lacking in reasonableness as to result in confiscation can the challenged statute be said to offend constitutional limitations. *Brushaber* v. *Union Pac. R. R., supra.* Such is clearly not the case here. In 1937 the petitioner sold the property it had acquired in the 1932 ex-

change. It was not until 1938 that this Court finally decided, in *United States* v. ***Hendler***, 303 U. S. 564, that under the revenue laws as then drafted the assumption of indebtedness, in what would otherwise be a non-taxable exchange, would result in taxable gain.[4] In order to remove the so-called defect in the revenue laws uncovered by that decision, Congress passed Section 213 (f) in 1939.[5] When the transaction was originally entered into, the transferor, who created the petitioner and acquired all of its stock, did not report the gain from the transaction because he regarded the exchange as a non-taxable one (see R. 16, 22, 36)—under which the petitioner would take over his basis. The effect of the *Hendler* decision in 1938 would have been to change that result, and to make the 1932 exchange a taxable one resulting in gain to the transferor and in a new basis to the petitioner. Section 213 (f) of the 1939 Act removes the effect of that decision,

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[4] Prior thereto, and even prior to the petitioner's sale, there were conflicting decisions on that point. Cf. *Hendler* v. *United States*, 17 F. Supp. 558 (Md.), and *Brons Hotels, Inc.* v. *Commissioner* 34 B. T. A. 376. Hence, there is no basis for the suggestion that petiitoner has had its expectations disappointed. (See R. 53.) Moreover, even if petitioner had actually been disappointed, that would not necessarily compel the conclusion that its rights have been injured in the constitutional sense.

[5] See report of Committee on Ways and Means, H. Rep. No. 855, 76th Cong., 1st Sess., p. 19.

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and restores the situation to its original status. Clearly, there is no basis for the suggestion (Pet. 7) of any lack of "fair play."

The gift and estate tax cases cited (Pet. 5–6) by petitioner (*Nichols* v. *Coolidge*, 274 U. S. 531; *Blodgett* v. *Holden*, 275 U. S. 142; *Untermeyer* v. *Anderson*, 276 U. S. 440; *Coolidge* v. *Long*, 282 U. S. 582; *Helvering* v. *Helmholz*, 296 U. S. 93; *White* v *Poor*, 296 U. S. 98) involve objections not present here. Cf. *Cooper* v. *United States*, *supra*, pp. 411–412; *Milliken* v. *United States*, *supra*, pp. 21–22, 23; *Welch* v. *Henry*, *supra*, p. 147. Here Congress, as a concession to taxpayers, simply provided retroactively for non-taxability of certain exchanges that would otherwise have been taxable under the *Hendler* decision, and as a consequence, there followed a corresponding adjustment in basis under Section 113 (a) (8). The circumstances here are fairly comparable to those in *Welch* v. *Henry*, *supra*, although less extreme than those present in that case; the legislation herein, to the extent that it required an adjustment in basis, simply closed a loophole and prevented petitioner from obtaining a windfall through the use of an artificially "stepped-up" basis.

CONCLUSION

The decision of the court below is correct and is in accord with the principles established by the applicable decisions of this Court. There is no conflict of decisions. The petition should therefore be denied.

Respectfully submitted.

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